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Office of Inspector General
Northeast Region

Audit Report

Food and Nutrition Service JPMorgan EFS' Oversight of EBT Operations

Report No. 27099-69-Hy
September 2007



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



September 28, 2007

REPLY TO

ATTN OF: 27099-69-Hy

TO: Roberto Salazar
Administrator
Food and Nutrition Service

ATTN: Lael Lubing
Director
Grants Management Division

FROM: Robert W. Young /s/
Assistant Inspector General
for Audit

SUBJECT: JPMorgan EFS' Oversight of Electronic Benefits Transfer Operations

This report presents the results of our audit of the JPMorgan EFS' Oversight of Electronic Benefits Transfer Operations. Your response to the official draft, dated September 26, 2007, is included as exhibit B. Excerpts of your response and the Office of Inspector General's (OIG) position are incorporated into the Findings and Recommendations section of the report. Based on your response, we were able to reach management decision on Recommendation 5. Please follow your agency's internal procedures in forwarding final action correspondence to the Office of the Chief Financial Officer. Management decisions for Recommendations 1, 2, 3, and 4 can be reached once you have provided us with the additional information outlined in the OIG Position section after each recommendation.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the planned corrective actions and the timeframes for implementation for Recommendations 1, 2, 3, and 4. Please note that regulation requires management decision to be reached on all findings and recommendations within 6 months from report issuance.

We appreciate the courtesies and cooperation extended to us by members of your staff during this audit.

Executive Summary

Food and Nutrition Service - JPMorgan EFS' Oversight of EBT Operations (Audit Report No. 27099-69-Hy)

Results in Brief

The Food Stamp Act of 1977, Public Law 88-525, authorized the Food and Nutrition Service (FNS) to experiment with alternative methods for the delivery of Food Stamp Program (FSP) benefits using electronic data processing and computer technology. With this authorization, FNS allowed State agencies to begin issuing FSP benefits using an Electronic Benefits Transfer (EBT) system. EBT is an electronic system that allows a recipient to authorize transfer of their government benefits from a Federal account to a retailer account to pay for products received. EBT has been implemented in all States since June 2004.

The Office of Inspector General (OIG) has monitored and audited implementation of EBT by FNS and States since its inception. The objectives of our current audit were to assess the operation of EBT system controls established by EBT processor, JPMorgan Electronic Financial Services (EFS) and review its compliance with applicable laws and regulations.¹

We concluded that JPMorgan EFS' oversight of EBT operations was generally adequate and overall compliant with laws and regulations; however, the audit disclosed that the standard JPMorgan EFS system configuration could create differences between household account balances on the EBT system and the underlying benefit records for those accounts due to unapplied benefits² and lead to the processing of excessive refunds and misuse of FSP funds.

- Federal regulations³ require that the States reconcile benefits posted to household accounts on the EBT central computer⁴ (JPMorgan EFS's Debit File) against benefits in the Issuance Authorization File (JPMorgan EFS's Benefit File). In addition, the regulations require that the States reconcile funds entered into, exiting from, and remaining in the system each day and maintain audit trails that document the full cycle of benefit issuance.

Unapplied benefits are created when refunds are posted to a household's account on the EBT system but not to the underlying benefit records in the Benefit File. All retailer-approved refunds are

¹ 7 C.F.R. 274.12; 7 C.F.R. 277.18

² Transactions that cannot be applied to a specific EBT benefit record.

³ 7C.F.R. 274.12 (k)(1)(i), (v) and (vi)

⁴ We will refer to the EBT central computer as the EBT system in the remainder of the report.

automatically returned to a household's account on the EBT system through real time processing. However, the refunds are returned to the household's Benefit File using a batch drawdown process run at various intervals throughout the day. The benefit records in the Benefit File are periodically purged due to age. According to JPMorgan EFS, if there is no benefit record against which to apply the refund, JPMorgan EFS will create an unapplied benefit record in the Benefit file.

The standard JPMorgan EFS system configuration does not include a process to track unapplied benefits over time. As a result, State Agencies may not be able to perform required reconciliations and validate the fiscal integrity of the EBT system.

- FNS and the New York State Agency provided OIG with documentation that 16 FSP recipients completed 737 fraudulent and 287 potentially fraudulent refunds during fiscal years 2005 and 2006 totaling nearly \$100,000. The California State Agency provided OIG with evidence that FSP recipients completed 217 potentially fraudulent refunds during fiscal years 2006 and 2007 for over \$23,000. In some instances, the recipients are taking part in a scheme to obtain cash for refunds posted to their accounts. In other instances, recipients misrepresent themselves as an EBT vendor, FNS official, or third-party processor representative in order to convince unsuspecting retailers to process refund transactions. Although there is no loss of Federal funds, the unsuspecting retailers are the victims of fraud. In addition, the recipients perpetrating the fraud are committing intentional program violations as defined by Federal regulations.⁵

The JPMorgan EFS system configuration periodically purges benefit records in the Benefit File that have been drawn down to \$0. In addition, JPMorgan EFS batch processes transactions to the Benefit File rather than processing them in real time. This allows refunds, posted in real time to household accounts on the EBT system, that do not have an underlying benefit record in the Benefit File. There are no limits as to the number of refund transactions or maximum total value of refunds processed for each recipient per month. FNS has not performed reviews to identify excessive refunds because, according to FNS officials, the problem was limited to New York City, with the potential to happen only in other JPMorgan EFS States. Also, the EBT processor does not provide daily refund reports that would assist in reviews of refund transactions. As a result, FSP funds were

⁵ 7 C.F.R. 273.16(c)(1) and (2)

received through fraudulent and potentially fraudulent transactions and may be used for other than their intended purpose.

Federal regulations⁶ require EBT systems to have upper limits on refunds to prevent and control damage to the system accounts. Additionally, the regulations⁷ require that the EBT system provide reports that enable the State Agency to manage the system.

Because the standard JPMorgan EFS system configuration may create unapplied benefits and allow excessive refunds, FNS needs to require the States to work with JPMorgan EFS to develop ways to eliminate or track unapplied benefits and strengthen controls over refunds. These actions are critical because 33 States and territories use JPMorgan EFS as their primary contractor. In addition, JPMorgan EFS issued nearly \$19 billion in FSP benefits in FY 2006.

Recommendations In Brief

FNS should require the States to work with JPMorgan EFS to: Establish a standard process for comparing benefits remaining in the Benefit File with the balance in the household accounts on the EBT system; lower ceilings for refunds and establish reasonable limits on the number and total dollar value of refunds approved for recipients each month; request that benefit records remain in the Benefit File for a longer period of time before they are purged; and in future procurement actions, include language in Request for Proposals that addresses real time processing of refund transactions to benefit records in the Benefit File and production of daily and monthly refund reports.

Agency Response

FNS agreed to all five report recommendations. We have incorporated FNS' response in the Findings and Recommendations section of this report, along with the OIG position. FNS' response is included as Exhibit B.

OIG Position

Based on FNS' response, we were able to reach management decision on Recommendation 5. Management decision on Recommendations 1, 2, 3, and 4 can be reached once FNS has provided us with the additional information outlined in the report section, OIG Position.

⁶ 7 C.F.R. 274.12 (i)(3)(iii)(B)

⁷ 7 C.F.R. 274.12 (k)(2)

Abbreviations Used in This Report

ACS	Affiliated Computer Services
C.F.R.	Code of Federal Regulations
EBT	Electronic Benefits Transfer
EFS	Electronic Financial Services
FNS	Food and Nutrition Service
FSP	Food Stamp Program
FY	Fiscal Year
HQ	Headquarters
ID	Identification
OIG	Office of Inspector General
POS	Point of Sale
P.L.	Public Law
PwC	PricewaterhouseCoopers
RFP	Request for Proposal
SAS	Statements on Auditing Standards
TPP	Third-Party Processor
USDA	U.S. Department of Agriculture

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Background and Objectives

Background

The U.S. Department of Agriculture's (USDA) Food and Nutrition Service (FNS) administers the Food Stamp Program (FSP) which assists low-income households by increasing their ability to purchase food. Once a month, each participating household receives a benefit allotment determined by the number of individuals in the family, household income, and other related factors. Recipients can use the benefits to pay for food items at participating food retailers.

The Food Stamp Act of 1977, Public Law (P.L.) 88-525, authorized FNS to experiment with alternative methods for the delivery of FSP benefits using electronic data processing and computer technology. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996, P.L. 104-193, required all States⁸ to implement EBT systems before October 1, 2002, unless the requirement was waived. Additionally, the EBT Interoperability and Portability Act of 2000 mandated cost-effective portability of food stamp benefits across State borders by October 1, 2002.

The FSP is administered by FNS through a Federal-State partnership. The Federal Government pays the full cost of recipient benefits and shares the cost to administer the FSP with the States. Congress funds the FSP through direct appropriation. In Fiscal Year (FY) 2006, over \$30 billion in FSP benefits were issued through EBT systems.

Before EBT, the basic method of FSP benefit delivery was the food stamp coupon. EBT was developed to replace paper coupons with an electronic system. Using plastic cards, much like a debit card along with a Personal Identification Number, recipients gain access to benefits through point of sale (POS) terminals located at approved food retailers.

FNS has established approval rules for the delivery of FSP benefits using EBT systems in Title 7 Code of Federal Regulations (C.F.R.) § 274.12, dated January 1, 2006, and for approving automated data processing systems in Title 7 C.F.R. § 277.18, dated January 1, 2006. The FSP regulations specify functional areas to be addressed by the State agency but do not establish a standardized system of internal controls. FNS' policy is to allow the States the flexibility to establish control systems that meet the needs of the individual States.

⁸ For purposes in this report, "States" will refer to all 50 U.S. States, Guam, Puerto Rico, Virgin Islands, and Washington D.C.

Generally, States award contracts to private sector companies to develop and operate their EBT systems. These companies are usually financial institutions or other organizations that already handle debit and credit card systems or electronic funds transfer activities. However, the States remain financially liable to the Federal Government for actions of their EBT processors. As of September 2006, there were four prime EBT contractors plus three States who were acting as their own prime contractor. A prime contractor is the contractor selected by the State to oversee all EBT functions; however, the EBT processing function may be performed by another entity. Thirty-three States and territories have selected the same prime contractor, JPMorgan Electronic Financial Services (EFS). Nearly \$19 billion of the approximately \$30 billion in FSP benefits for FY 2006 were issued through State EBT systems for which JPMorgan EFS was the prime contractor.

JPMorgan EFS provides electronic benefit transfer services to Federal and State governments as required by the 1996 Personal Responsibility and Work Opportunity Reconciliation Act. A government agency (i.e., benefit issuer) distributes needs-tested benefits by establishing accounts that may be accessed by recipients electronically through an automatic teller machine or a retail POS terminal.

Objectives

The objectives of the audit were to (1) determine and assess the operation of EBT system control established by JPMorgan EFS and (2) review JPMorgan EFS compliance with applicable laws and regulations.

To accomplish these objectives, we reviewed two prior JPMorgan EFS Statement on Auditing Standards (SAS) No. 70 Reports titled “Report on Controls over the Processing of Transactions” for periods July 1, 2004 to June 30, 2005 and July 1, 2005 to June 30, 2006, respectively, performed by PricewaterhouseCoopers (PwC) Limited Liability Partnership. OIG reviewed PwC workpapers for the 2006 SAS 70 Report. We interviewed JPMorgan EFS, FNS, and various State Agency officials to obtain supplementary information and documentation as needed.

Findings and Recommendations

Section 1. JPMorgan EFS' System Configuration

JPMorgan EFS' oversight of EBT operations was generally adequate and complied with applicable laws and regulations. JPMorgan EFS strategically instituted a segregation of functions, which is inherent to their internal controls. The JPMorgan EFS Command Center Services Group performed monitoring tasks to ensure positive acknowledgment between the State and the data center that all transmitted data was received and the transaction totals matched before updating the EBT system database. Also, JPMorgan EFS protected telecommunications with encryption software on both the JPMorgan EFS server and the server of the States (benefit issuers).

JPMorgan EFS conducts day-to-day EBT activities at the operation center in Tampa, Florida. EBT processing was performed at the data centers in Weehawken, New Jersey and Silver Spring, Maryland at the time of the audit, but have since moved to Brandywine, Delaware and Elk Grove, Illinois. JPMorgan EFS controlled access to each facility with a multi-level computerized card access system. Visitors must register with security officers, wear a visitor's badge, and be escorted by JPMorgan personnel at all times. Additionally, JPMorgan EFS limited access to the EBT system to authorized users and issued IDs and passwords. As a part of environmental controls, JPMorgan EFS equipped the data centers with smoke detectors and sprinklers, as well as monitoring equipment to control the temperature and humidity.

In addition, JPMorgan EFS used hiring practices designed to ensure that new employees were qualified for their job responsibilities. JPMorgan EFS checked references and performed background and security checks, including fingerprinting, criminal record checking, and drug testing.

During the audit entrance conference, FNS requested that OIG review controls over refunds. In addition, FNS asked OIG to evaluate unapplied benefits⁹ and the New Mexico State agency's method of expungement.¹⁰

Our work on unapplied benefits and refunds disclosed that the standard JPMorgan EFS system configuration could result in the creation of unapplied benefits and allow for the processing of excessive refunds. Excessive refunds may contribute to the level of unapplied benefits. In

⁹ Unapplied benefits are transactions that cannot be applied to a specific EBT benefit record.

¹⁰ Expungement is the removal of a benefit from a recipients account due to a preset duration of inactivity in the account.

addition, the unapplied benefits may prevent State Agencies from validating the fiscal integrity of the EBT system.

Regarding FNS' request to review expungements, OIG interviewed pertinent New Mexico officials, obtained expungement documentation, and determined that the EBT system is now capable of performing grant¹¹ level expungements of aged benefits.

Finding 1**The Standard JPMorgan System Configuration Can Create Unapplied Benefits That Cause Reconciliation Issues and Potential Misuse of FSP Funds**

The standard JPMorgan EFS system configuration can create differences between household account balances on the EBT system and the underlying benefit records for those accounts. Unapplied benefits are created when refunds are posted to household accounts on the EBT system but not to underlying benefit records that were previously purged from the Benefit File.¹² The standard system configuration does not include a process to track the difference between total benefits remaining in the Benefit File with the balance in the household accounts on the EBT system. As a result, State agencies may not be able to perform required reconciliations and validate the fiscal integrity of the EBT system. This configuration can also lead to the misuse of FSP benefits. (See Finding 2)

Federal regulations¹³ require that the States reconcile benefits posted to household accounts on the EBT central computer¹⁴ (JPMorgan EFS's Debit File) against benefits in the Issuance Authorization File (JPMorgan EFS's Benefit File). In addition, the regulations require that the States reconcile funds entered into, exiting from, and remaining in the system each day and maintain audit trails that document the full cycle of benefit issuance.

On a daily basis, States send Issuance Authorization Files to JPMorgan EFS. The issuance authorizations are verified for accuracy then posted to individual benefit records in the Benefit File and deposited in household accounts in the Debit File on the EBT system. The Benefit File acts as the Issuance Authorization File for reconciliation purposes. Over time, in the standard JPMorgan EFS system, the overall household account totals in the Debit File on the EBT system do not always match the sum of the individual benefit records in the Benefit File. This difference is due to

¹¹ Grant level expungement is the removal of only the oldest benefit in a recipients account after a preset duration; as opposed to account level expungement which removes all benefits in a recipients account once any benefit reaches the preset aged limit.

¹² The amount of time to purge benefit records drawn to \$0 varies from State to State (30, 60, 90 days, etc.)

¹³ 7 C.F.R. 274.12 (k)(1)(i), 7 C.F.R. 274.12 (k)(1)(v) and 7 C.F.R. 274.12 (k)(1)(vi)

¹⁴ We will refer to the EBT central computer as the EBT system in the remainder of the report.

unapplied benefits that may affect the State's ability to validate the fiscal integrity of the EBT system.

Unapplied benefits are created in the following way. JPMorgan EFS purges individual benefit records in the Benefit File that have been drawn down to \$0 after a certain amount of time has elapsed. The amount of time varies from State to State (30, 60, 90 days etc.). If a retailer processes a refund for a recipient, the full value of the refund is automatically credited to the household account in the Debit File on the EBT system in real time. However, JPMorgan EFS updates the benefit records in the Benefit File using a batch "drawdown"¹⁵ process run at various intervals throughout the day. During the drawdown process, JPMorgan EFS returns the refund amount to the most recently opened benefit record in the Benefit File up to the original amount of that benefit. If the most recently opened benefit record is returned back to its original value and there still are additional refund monies available to be posted, JPMorgan EFS will open the next oldest benefit record and apply the remaining refund up to the original amount of that benefit. If there are additional refund monies available to be posted but no more benefit records available, then JPMorgan EFS will apply the entire remaining refund amount to the oldest benefit record. If there is no benefit record at all against which to apply the refund, JPMorgan EFS will create an unapplied benefit record in the Benefit file. In the standard JPMorgan EFS configuration, this occurs because the household account on the EBT system does not have a corresponding benefit record against which to apply the refund amount.

Unapplied benefits only show up in the Benefit File on the day they occur. There is no record to track them over time. Therefore, if a State does not track these on a daily basis or makes a mistake in tracking these benefits, a particular household's account balance in the Debit File may not equal the benefits left to that household in the Benefit File.

JPMorgan EFS has worked with several States to help them understand and deal with unapplied benefits. In addition, JPMorgan EFS officials participated in a panel discussion to address State's concerns about the seriousness of unapplied benefits in a presentation to State EBT Directors in April 2007. JPMorgan EFS officials offered to work with States who feel that unapplied benefits have not been satisfactorily explained. In addition, based on requests from Florida and New York, JPMorgan EFS introduced a batch process called grant re-synchronization that compares the total benefits remaining in the Benefit File to the household account balances in the Debit File. If the household account value exceeds the Benefit File total, the system automatically creates a holding record for the

¹⁵ A process where FSP purchases/redemptions are deducted from, or in the case of a refund, added to the individual benefit records.

unapplied benefits. With these unapplied benefits included in the Benefit File, States can calculate the ending benefit balance, perform the required reconciliations and validate the fiscal integrity of the EBT system.

During fieldwork, FNS and JPMorgan EFS staff explained that an accurate assessment of the extent of unapplied benefits, from the inception of the EBT system, could take months for each State. Consequently, we decided to determine the extent of daily unapplied benefit activity for a sample of days during our audit fieldwork. We selected eight days between November 2006 and February 2007 to identify the extent of daily activity for unapplied benefits. During the period of review seven States (Arizona, California, Florida, Georgia, New York, Pennsylvania and Washington) reported various levels of daily unapplied benefit activity from a low of \$0.41 for Florida on January 24, 2007, to a high of \$147.08 for California on February 2, 2007. Although the daily activity was low, the cumulative effect could become significant over time, and without tracking, could prevent accurate reconciliation and the validation of the fiscal integrity of the EBT system. In fact, 3 out of 33 JPMorgan EFS' States cited unapplied benefits as a concern during the audit.

States experiencing continuing problems with unapplied benefits should work with JPMorgan EFS to implement a solution similar to Florida and New York. In addition, States should work with EBT processors to explore the feasibility of real time processing of transactions to benefit records in the Benefit File in future EBT systems. States can also request that benefits records remain in the Benefit File for a longer period of time before purging the used benefits. These actions are critical because 33 States and territories use JPMorgan EFS as their primary contractor. In addition, JPMorgan EFS issued nearly \$19 billion in FSP benefits in FY 2006.

Recommendation 1

Require States that are experiencing problems with unapplied benefits to request that JPMorgan EFS incorporate the grant re-synchronization process into their regular drawdown process on at least a daily basis.

Agency Response

The Food and Nutrition Service (FNS) accepts the recommendation and will issue a directive to all States currently processed by JPMorgan to take the recommended action. As noted in Finding 1, JPMorgan has already worked with several States to implement the new process. We will request each State to verify whether JPMorgan has, in fact, implemented grant re-synchronization for their system, and that it is incorporated into all drawdown processing (which is performed at least daily for smaller States,

and several times a day for larger ones). FNS will take action to ensure that States that have not yet implemented grant re-synchronization do so in a timely manner. Additionally, FNS will monitor drawdown reports produced by JPMorgan for each State to validate that beginning and ending balances for unapplied benefits are calculated and displayed.

OIG Position

We do not accept FNS' management decision. While OIG concurs with FNS proposed course of action, in order to accept management decision, FNS needs to provide OIG with proposed completion dates for implementing each proposed corrective action in the response.

Recommendation 2

Require States with potential future contracts with EBT processors to request real time processing of refund transactions to benefit records in the Benefit file. In the interim, States can request that benefits records remain in the Benefit File for a longer period of time before they are purged.

Agency Response

We agree with the finding that led to this recommendation and have taken steps toward implementation. FNS reviews and approves all Requests for Proposal (RFP) for State EBT systems prior to release. We also require all EBT contracts to have FNS approval. FNS is currently updating the RFP Guidance document that was developed when States were first bringing up EBT. The updated RFP Guidance document, which FNS hopes will be issued early next spring, if not sooner, will address the need for real time processing of refunds to benefit records. FNS will also issue a notice to current JPMorgan States recommending that benefit records be maintained on the EBT system for longer periods of time.

OIG Position

We do not accept FNS' management decision. While OIG concurs with FNS proposed course of action, in order to accept management decision, FNS needs to provide OIG with a more specific proposed completion date for issuing the updated RFP Guidance and a proposed completion date for issuing the notice to current JPMorgan States recommending that benefit records be maintained on the EBT system for longer periods of time.

Finding 2**State Refund Controls Need Strengthening**

The audit disclosed that excessive refunds were processed in New York and California. FNS and the New York State Agency provided OIG with documentation that 16 FSP recipients completed 737 fraudulent and 287 potentially fraudulent refunds during fiscal years 2005 and 2006 for nearly \$100,000. The California State Agency provided OIG with evidence that FSP recipients completed 217 potentially fraudulent refunds during fiscal years 2006 and 2007 for over \$23,000. In some instances, the recipients are taking part in a scheme to obtain cash refunds posted to their accounts. In other instances, recipients misrepresent themselves as an EBT vendor, FNS official, or third-party processor representative in order to convince unsuspecting retailers to process refund transactions. Although there is no loss of Federal funds, the unsuspecting retailers are the victims of fraud. In addition, the recipients perpetrating the fraud are committing intentional program violations as defined by Federal regulations.¹⁶

Although most States, including New York, have limits as to the maximum dollar amount of refunds, there are no limits as to the number of refund transactions or maximum total value of refunds processed for each recipient per month. FNS has not performed reviews to identify excessive refunds because, according to FNS officials, the problem was limited to New York City, with the potential to happen only in other JPMorgan EFS States. Additionally, the EBT processor does not provide daily refund reports that would assist in reviews of refund transactions. As a result, FSP funds were received through potentially fraudulent transactions and may be used for other than their intended purpose.

Federal regulations¹⁷ require EBT systems to have upper limits on refunds to prevent and control damage to the system accounts. Additionally, the regulations¹⁸ require that the EBT system provide reports that enable the State Agency to manage the system.

Due to the extent of the problem, we contacted the New York State Agency to determine whether corrective actions had been taken against the most serious program violators. The State Agency informed OIG that they referred the most serious violator who obtained more than \$44,000 in fraudulent refunds to the District Attorney for criminal prosecution. They notified FNS about two others who obtained more than \$12,000 in fraudulent refunds and referred them to New York's Bureau of Fraud and Investigations for intentional program violation claims.

¹⁶ 7C.F.R. 273.16(c)(1) and (2)

¹⁷ 7 C.F.R. 274.12 (i)(3)(iii)(B)

¹⁸ 7 C.F.R. 274.12 (k)(2)

JPMorgan EFS officials explained that they set the refund ceiling as prescribed by the States. We contacted the 33 States for which JPMorgan EFS serves as the EBT processor to obtain refund limits by State. We were able to determine that the refund upper limitations vary from State to State. In States where a prescribed limit is set, amounts range from \$50 to \$250. Ten States allow refunds up to the full amount of the purchase in question, while three States do not have a set limit. In one State, the limit is set by the retailers (See Exhibit A). New York reduced its refund limit from \$250 to \$75 as a result of the excessive refunds processed.

In May 2007, California notified us that retailers in the State may have also been the victim of fraud. From January to April 2007, California FSP recipients completed 78 potentially fraudulent refunds for over \$8,000. Likewise, in 2006, recipients completed 139 potentially fraudulent refunds for over \$15,000. California is working with OIG's Office of Investigations to address the problem.

To strengthen controls over refunds processed through State EBT systems, FNS should require States that update benefit records via batch processing and have no refund ceiling or an unreasonably high ceiling, to lower their thresholds for refunds and to limit the maximum number of refunds per client per month and the maximum total value of refunds allowed per month. However, these limits need to be reasonable enough to handle legitimate client's needs. FNS should also require the States to request that the EBT contractor provide daily and monthly refund reports in their next Request for Proposal (RFP). Finally, FNS should develop an action plan with specific milestone dates to identify States that process potentially fraudulent refunds and initiate corrective actions as appropriate.

In Finding 1 we recommended that FNS require States with potential future contracts with EBT processors to request real time processing of refund transactions to benefit records in the Benefit File. Real time processing of transactions to the Benefit File would eliminate the ability of FSP recipients to receive refunds in excess of their benefits because system updates become automatic instead of daily/nightly.

Recommendation 3

Require States that update benefit records via batch processing and have no refund ceiling or an unreasonably high ceiling, to lower the refund ceiling and limit the number and total dollar value of refunds that will be approved for recipients each month. However, these limits need to be reasonable enough to handle legitimate client's needs.

Agency Response

We accept the finding that led to this recommendation and will work with the States listed in Exhibit A as having no set ceiling or an unreasonably high ceiling for refunds. Following some data analysis, we will also request limits on the number and dollar value of refunds that would be approved for recipients each month. FNS began maintaining refund transaction data beginning with system changes implemented in June 2007 and will analyze this data to help determine appropriate refund limits that will accommodate legitimate client needs. Once reasonable limit options are established, FNS will work with the appropriate States.

OIG Position

We do not accept FNS' management decision. While OIG concurs with FNS proposed course of action, in order to accept management decision, FNS needs to provide OIG with proposed completion dates for completing the data analysis on refunds, determining appropriate refund limits, and requesting limits to be set by the States.

Recommendation 4

Require States to include language in their next RFP that will lead to the design of an EBT system that provides daily and monthly refund reports that address the problem of excessive refunds. Develop and implement controls to ensure that each State submits an RFP with the required language.

Agency Response

We agree with the finding that led to this recommendation and will address any appropriate requirement in our revised RFP Guidance noted above. FNS will also develop recommended language on the subject to share with States as we are doing with respect to recommendation 2. However, until we conduct further analysis on what data we have available and discuss the issue further with relevant States, we are unsure as to whether a new set of State EBT reports is necessary or warranted, given that FNS already collects all transaction data for ALERT and is analyzing that data. If we conclude that additional State reports are warranted, we will address this with the relevant States, as appropriate and incorporate it into the RFP Guidance.

OIG Position

We do not accept FNS' management decision. To accept management decision, FNS needs to identify what actions it will initiate with ALERT to analyze refund transactions if it is determined that a new set of EBT

refund reports is unnecessary. Currently, ALERT does not analyze refund transactions. In addition, FNS needs to provide OIG with proposed completion dates for implementing proposed corrective actions.

Recommendation 5

Develop an action plan with specific milestone dates to identify States that process potentially fraudulent refunds and initiate corrective actions as appropriate.

Agency Response

We accept this finding and will develop an Action Plan. The FNS action plan will focus on researching and analyzing six months worth of refund transaction activity that will be available starting in November 2007. We expect the research will identify patterns and trends that can be used to determine any additional reports that may be needed to flag suspect transactions as well as the need for supplemental guidance to retailers who are vulnerable to refund scams. FNS plans to complete its initial research by February 2008.

OIG Position

OIG accepts FNS' management decision.

Scope and Methodology

To accomplish our objectives, we performed work at the FNS National Office in Alexandria, Virginia and the offices of JPMorgan EFS and PwC in Tampa, Florida.

Per Federal Regulations,¹⁹ JPMorgan EFS is annually reviewed by independent auditors, who perform their reviews in accordance with American Institute of Certified Public Accountants Statement on Auditing Standards (SAS) No. 70, Service Organizations. PwC is the independent auditing firm that performs the annual SAS 70 audit of JPMorgan EFS.

In order to minimize the duplication of audit efforts and in accordance with Federal regulations,²⁰ OIG reviewed PwC's independence confirmations and assessed the professional qualifications of PwC by reviewing their latest external peer review. In order to place reliance on PwC's SAS 70 Report on Controls over the Processing of Transactions for the period of July 1, 2005 to June 30, 2006, we reviewed PwC's audit working papers. OIG determined that the working papers provided the level of assurance needed to conclude that audit documentation was complete, accurate, met our requirements and Generally Accepted Government Auditing Standards.

Because of our ability to rely on the work of PwC, OIG was able to minimize redundant audit work in the areas of (1) Organizational and Operational Controls, (2) Data and Procedure Controls, (3) Processing Controls, (4) Input and Output Controls, (5) Identification and Authentication Controls, (6) Telecommunication Security, and (7) Physical and Environmental Security.

OIG performed additional audit tests beyond the scope and extent of testing in the SAS 70 audit as follows:

- Determined system programming for application of current month's redemption to benefits authorized in previous months.
- Documented the technical feasibility of POS terminals being moved from retailer premises and used in unauthorized locations.
- Determined if any approved waivers to FNS EBT regulations affected the overall security at JPMorgan EFS.
- Identified, obtained, reviewed, and evaluated certification standards.

¹⁹ 7 CFR 274.12(k)(5)(i)

²⁰ 7 CFR 274.12(k)(vi) – Examinations and Audits

- Assessed EBT processor's compliance with transaction processing time requirements.
- Obtained August 2006 FSP authorization data for Colorado for each day and reconciled the JPMorgan EFS receipt of the FSP authorizations to the data provided by the State.
- Reviewed procedures to handle manual transaction data.
- Reviewed and analyzed three months of FSP data including the total number and amounts of FSP redemptions and manual FSP redemptions.
- Reviewed a random sample of 30 manual vouchers from a universe of 46,348 manual voucher transactions for the period June through August 2006 for Colorado, New Mexico, New York and Pennsylvania to determine if manual transactions were processed correctly.
- Reviewed roles and responsibilities for telecommunications security.
- Identified the role of Third Party Processors (TPP) in JPMorgan EFS' processing activities and reviewed procedures for TPP certification by JPMorgan EFS.
- Per FNS Headquarters (HQ) request, interviewed pertinent officials to determine whether the New Mexico EBT system implemented grant level expungement of aged benefits.
- Per FNS HQ request, interviewed pertinent staff and officials within FNS, the States, and JPMorgan EFS, and reviewed data related to unapplied benefits and refunds in JPMorgan EFS States.

FNS and JPMorgan EFS staff explained that an accurate assessment of the extent of unapplied benefits, from the inception of the EBT System, could take months for each State. Consequently, we decided to determine the extent of daily unapplied benefit activity for a sample of days during our audit fieldwork. We judgmentally selected eight days between November 2006 and February 2007 to identify the extent of daily activity for unapplied benefits. JPMorgan EFS furnished the information via Non-Applied Transaction Reports, listing the data for all 33 JPMorgan EFS' States, for each of the selected days.

Fieldwork was conducted from August 2006 through May 2007. The audit was performed in accordance with Generally Accepted Government Auditing Standards.

Exhibit A – JPMorgan EFS States and Applicable Refund Amounts as Provided by the States

Exhibit A – Page 1 of 1

State	Allowable Refund Amount
Alaska	*Up to full purchase amount
Arizona	No limit set
California	*Up to full purchase amount
Colorado	*Up to full purchase amount
Connecticut	\$250
Florida	\$250
Georgia	*Up to full purchase amount
Guam	*Up to full purchase amount
Hawaii	\$250
Idaho	*Up to full purchase amount
Indiana	\$250
Louisiana	\$250
Kentucky	*Up to full purchase amount
Maryland	Limit is set by retailers
Michigan	\$200
Nebraska	\$250
Nevada	\$250
New Hampshire	No limit set
New Mexico	\$250
New York	\$75
North Dakota	\$250
Oklahoma	\$50
Pennsylvania	No limit set
South Carolina	\$250
South Dakota	\$250
Tennessee	*Up to full purchase amount
Virginia	*Up to full purchase amount
Virgin Islands	*Up to the purchase amount
Washington State	\$250
Washington DC	\$250
West Virginia	\$250
Wisconsin	No limit set
Wyoming	\$75

* As documented on the store receipt

Exhibit B – Agency Response

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United States
Department of
Agriculture

Food and
Nutrition
Service

3101 Park
Center Drive

Alexandria, VA
22302-1500

SEP 26 2007

SUBJECT: OIG Audit 27099-69-HY: JP Morgan EFS Oversight of Electronic Benefits Transfer (EBT) Operations

TO: Robert W. Young
Assistant Inspector General for Audit
Office of Inspector General

This memorandum is in response to the subject audit's findings and five recommendations. We concur with the findings and offer the following response:

Recommendation 1 – Require States that are experiencing problems with unapplied benefits to request that JP Morgan EFS incorporate the grant re-synchronization process into their regular drawdown process on at least a daily basis.

The Food and Nutrition Service (FNS) accepts the recommendation and will issue a directive to all States currently processed by JP Morgan to take the recommended action. As noted in Finding 1, JP Morgan has already worked with several States to implement the new process. We will request each State to verify whether JP Morgan has, in fact, implemented grant re-synchronization for their system, and that it is incorporated into all drawdown processing (which is performed at least daily for smaller States, and several times a day for larger ones). FNS will take action to ensure that States that have not yet implemented grant re-synchronization do so in a timely manner. Additionally, FNS will monitor drawdown reports produced by JP Morgan for each State to validate that beginning and ending balances for unapplied benefits are calculated and displayed.

Recommendation 2 – Require States with potential future contracts with EBT processors to request real time processing of refund transactions to benefit records in the Benefit file. In the interim, States can request that benefit records remain in the Benefit File for a longer period of time before they are purged.

We agree with the finding that led to this recommendation and have taken steps toward implementation. FNS reviews and approves all Requests for Proposal (RFP) for State Electronic Benefit Transfer (EBT) systems prior to release. We also require all EBT contracts to have FNS approval. FNS is currently updating the RFP Guidance document that was developed when States were first bringing up EBT. The updated RFP Guidance document, which FNS hopes will be issued early next spring, if not sooner, will address the need for real time processing of refunds to benefit records. FNS will also issue a notice to current JP Morgan States recommending that benefit records be maintained on the EBT system for longer periods of time.

AN EQUAL OPPORTUNITY EMPLOYER

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Recommendation 3 – Require States that update benefit records via batch processing and have no refund ceiling or an unreasonably high ceiling to lower the refund ceiling and limit the number and total dollar value of refunds that will be approved for recipients each month. However, these limits need to be reasonable enough to handle legitimate clients' needs.

We accept the finding that led to this recommendation and will work with the States listed in Exhibit A as having no set ceiling or an unreasonably high ceiling for refunds. Following some data analysis, we will also request limits on the number and dollar value of refunds that would be approved for recipients each month. FNS began maintaining refund transaction data beginning with system changes implemented in June 2007 and will analyze this data to help determine appropriate refund limits that will accommodate legitimate client needs. Once reasonable limit options are established, FNS will work with the appropriate States.

Recommendation 4 – Require States to include language in their next RFP that will lead to the design of an EBT system that provides daily and monthly refund reports that address the problem of excessive refunds. Develop and implement controls to ensure that each State submits an RFP with the required language.

We agree with the finding that led to this recommendation and will address any appropriate requirement in our revised RFP Guidance noted above. FNS will also develop recommended language on the subject to share with States as we are doing with respect to recommendation 2. However, until we conduct further analysis on what data we have available and discuss the issue further with relevant States, we are unsure as to whether a new set of State EBT reports is necessary or warranted, given that FNS already collects all transaction data for ALERT and is analyzing that data. If we conclude that additional State reports are warranted, we will address this with the relevant States, as appropriate and incorporate it into the RFP Guidance.

Recommendation 5 – Develop an Action plan with specific milestone dates to identify States that process potentially fraudulent refunds and initiate corrective actions as appropriate.

We accept this finding and will develop an Action Plan. The FNS action plan will focus on researching and analyzing six months worth of refund transaction activity that will be available starting in November 2007. We expect the research will identify patterns and trends that can be used to determine any additional reports that may be needed to flag suspect transactions as well as the need for supplemental guidance to retailers who are vulnerable to refund scams. FNS plans to complete its initial research by February 2008.

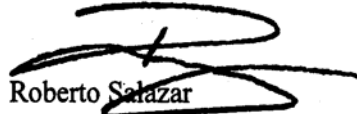
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In our review of the final draft, we identified one error from the previous draft that had not been corrected. The chart in Exhibit A lists Massachusetts as a JP Morgan State. They have been under contract with Affiliated Computer Services and processed by them since August 2005. Prior to that, JP Morgan was their prime contractor, but they were processed by eFunds. They have never been processed by JP Morgan. We ask that Massachusetts be removed from the list.

Please feel free to contact me at (703) 305-2062 or Jeff Cohen, Director, Benefit Redemption Division at (703) 305-2434 if you wish to discuss our response.


Roberto Salazar
Administrator